

Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-08 NSC-05
TRSE-00 SS-15 STR-06 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 MMO-01 SSM-03 PRS-01 PA-01 /086 W
-----021307 161225Z /10

R 161031Z JAN 78
FM AMEMBASSY TEL AVIV
TO SECSTATE WASHDC 0652

C O N F I D E N T I A L SECTION 1 OF 2 TEL AVIV 0698

E.O.11652: GDS
TAGS: EFIN, ECON, IS
SUBJ: ISRAEL'S FY 1978 BUDGET

REF: (A) 77 TEL AVIV A-220, (B) 77 TEL AVIV A-218, (C) 77 TEL
AVIV 10198

BEGIN UNCLASSIFIED

1. SUMMARY: FINANCE MINISTER EHRLICH SUBMITTED THE FY
78 BUDGET TO THE KNESSET JANUARY 9. AS IS CUSTOMARY,
THE FINANCE MINISTER ALSO PRESENTED THE OFFICIAL ES-
TIMATES FOR 1977 ECONOMIC PERFORMANCE AND PROJECTIONS
FOR 1978, AND OUTLINED THE GOI POLICY GUIDELINES FOR
THE COMING YEAR. THE BUDGET TOTALS IL182 BILLION AS
REPORTED REF A, ALTHOUGH SOME OF THE COMPONENTS HAVE
BEEN CHANGED; THE BUDGET DEFICIT IS PROJECTED AT IL6
BILLION. THE OFFICIAL ESTIMATES OF MAJOR ECO-
NOMIC INDICATORS IN 1977 AND 1978 SHOW SOME CHANGE
FROM EARLIER MINISTRY OF FINANCE FIGURES--PRINCIPALLY
THE LOWERED ESTIMATE OF 1977 REAL GNP GROWTH, WHICH
IS NOW PUT AT ONLY 0.5 PERCENT. THE BALANCE OF
PAYMENTS ON GOODS AND SERVICES IMPROVED AGAIN IN
1977; THE DEFICIT AMOUNTED TO \$2.7 BILLION. EHRLICH
SAID THAT SOLVING THE BALANCE OF PAYMENTS PROBLEM
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IS THE GOI'S TOP PRIORITY AND POLICY STEPS WILL BE
JUDGED ON THEIR CONTRIBUTION TO ITS SOLUTION. OTHER
MAIN POLICY GOALS ARE CONTINUATION OF EXPORT GROWTH,
SLOWING DOWN INFLATION, HIGHER ECONOMIC GROWTH, RE-
STRAINT OF LOCAL DEMAND, AND IMPROVEMENT IN PRO-
DUCTIVITY. PRESS REACTION HAS BEEN CRITICAL, AND
BANK OF ISRAEL ECONOMISTS HAVE ATTACKED THE GOVERN-

MENT'S BUDGETARY FORECASTS. END SUMMARY.

2. EHRlich SAID THAT ECONOMIC TRENDS ROOTED IN THE DECADES-LONG LABOR REGIME COULD NOT BE OVERTURNED IN ONE FISCAL YEAR, BUT FY 1978 SHOULD SEE THE RENEWAL OF ECONOMIC GROWTH (4 PERCENT) WHICH WOULD ACCELERATE GROWTH TO 7-8 PERCENT WITHIN THREE YEARS. EHRlich EMPHASIZED THAT THE BALANCE OF PAYMENTS REMAINS THE CENTRAL PROBLEM OF THE ECONOMY AND THAT POLICIES WILL BE JUDGED BY THEIR CONTRIBUTION TO ITS RESOLUTION. HE DESCRIBED THE OTHER PRINCIPAL OBJECTIVES OF SOCIO-ECONOMIC POLICY FOR FY 1978 AS:

- SLOWING THE RATE OF INFLATION,
- ACCELERATING THE RATE OF ECONOMIC GROWTH, HEADED BY AN INCREASE IN EXPORTS AND IN INVESTMENTS IN EXPORT-ORIENTED INDUSTRIES,
- CONTINUING RESTRAINT OF PRIVATE AND PUBLIC CONSUMPTION,
- INCREASING MANUFACTURING PRODUCTIVITY AND STREAMLINING OF SERVICES.

3. THE BUDGET PROJECTS EXPENDITURES OF IL182 BILLION AND RECEIPTS OF IL176 BILLION. ON THE EXPENDITURE SIDE, THE MAIN CHANGE FROM THE (PROPOSED) EARLIER VERSION REPORTED REF A IS THE ALLOTMENT OF SOME OF THE FUNDS TO BE HELD AS GENERAL RESERVES TO OTHER LINE ITEMS. AS SHOWN BELOW, THE MAJOR OUTLAYS REMAIN DEBT PAYMENT (32.7 PERCENT) AND DEFENSE SPENDING (30.4 PERCENT).

PROPOSED APPROVED
BUDGET BUDGET

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(IL MILLION)	FY 1978	FY 1977
TOTAL EXPENDITURES	182,000	123,960
DEFENSE	55,300	40,775
DEFENSE MINISTRY	54,440	40,120
EMERGENCY EXPENDITURES	900	655
AND ADMINISTERED AREAS		
REMAINDER OF ORDINARY BUDGET	50,500	40,105
OF WHICH: LOCAL AUTHORITIES	5,575	4,227
SUPPORT FOR PRICES OF BASIC		
COMMODITIES	3,000	2,765
DEVELOPMENT OF EXPORT MARKETS	200	6,040
RESERVES	7,196	6,824
DEVELOPMENT BUDGET	16,700	11,620
DEBT REPAYMENT AND		
CREDIT SUBSIDY	59,500	31,460
CREDIT SUBSIDY AND INTEREST		
REDUCTION	8,000	3,230
INTEREST	21,500	13,250
PRINCIPAL	30,000	14,980
TOTAL REVENUE	176,000	119,400
DOMESTIC REVENUE	137,300	95,110
TAXES AND COMPULSORY LOANS	90,700	67,800

REVENUE FROM ABROAD 44,700 28,850
DEFICIT 6,000 4,560

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ACTION NEA-10

INFO OCT-01 ISO-00 MMO-01 SP-02 USIA-06 AID-05 EB-08
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COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03
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C O N F I D E N T I A L SECTION 2 OF 2 TEL AVIV 0698

4. THE DEFICIT WILL BE FINANCED BY A LOAN FROM BANK
OF ISRAEL CREDIT. ACCORDING TO THE FINANCE MINISTER, THIS WILL BE
STRICTLY LIMITED TO IL6 BILLION. MINISTRIES WILL BE FORCED TO AB-
SORB ADDITIONAL COSTS IF INFLATION IS HIGHER THAN PREDICTED. NO
NEW TAXES WILL BE IMPOSED, ALTHOUGH THE VALUE-ADDED TAX (VAT)
MAY BE RAISED TO 14 PERCENT FROM ITS PRESENT 12 PERCENT TO
REPLACE SOME PURCHASE TAXES WHICH WILL BE ELIMINATED.

5. THE DETAILS OF THE "NATIONAL BUDGET", THE STATEMENT OF GOI
ECONOMIC POLICY AND OFFICIAL MACROECONOMIC PROJECTION FOR THE COM-
ING YEAR, WERE DISCUSSED BY THE MOF AND THE BANK OF ISRAEL RE-
SEARCH DEPARTMENT IN A PRESS CONFERENCE JANUARY 10. THE MAJOR
CHANGE FROM THE PRELIMINARY ESTIMATES, REPORTED REF B, IS IN THE
NATIONAL ACCOUNTS FIGURES. THE 1977 REAL GNP GROWTH RATE ESTIMATE
NOW IS ONLY 0.5 PERCENT. PRIOR PREDICTIONS HAD BEEN FOR 1-2 PER-
CENT. THE GROWTH RATE WAS 0.9 PERCENT IN 1976 AND 2.1 PERCENT IN
1975. THE DEFICIT IN THE GOODS AND SERVICES ACCOUNT WAS ABOUT
\$2.7 BILLION IN 1977, A \$550 MILLION IMPROVEMENT OVER THE 1976
PERFORMANCE. THE REDUCTION IN THE DEFICIT IS DUE PRIMARILY TO A
\$300 MILLION DROP IN THE VALUE OF DIRECT DEFENSE IMPORTS AND A
SIGNIFICANT IMPROVEMENT IN THE SERVICES ACCOUNT. NET FOREIGN EX-
CHANGE RESERVES OF THE BANK OF ISRAEL ON DEC 31 WERE \$1,380 MILLION,
AN INCREASE OF \$225 MILLION FOR THE YEAR.

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6. THE EMBASSY HAS NOT YET RECEIVED THE COMPLETE "NATIONAL BUDGET" FROM THE BOI. WHEN IT BECOMES AVAILABLE, WE WILL TRANSLATE AND REPORT THE MAIN POINTS. END UNCLASSIFIED.

7. BEGIN CONFIDENTIAL. THE EMBASSY ESTIMATES THAT, USING STANDARD ACCOUNTING TECHNIQUES (SEE 77 TEL AVIV A-53), FOREIGN EXCHANGE RESERVES AT THE END OF 1977 WERE ABOUT \$1,600 MILLION. IN ADDITION, FOREIGN CURRENCY HELD IN GOI ACCOUNTS ABORAD--WHICH ARE NOT COUNTED IN BOI RESERVES--ROSE TO \$150 MILLION MORE THAN THE NORMAL LEVEL IN THE FIRST HALF OF 1977. YEAR-END FIGURES FOR THESE ACCOUNTS WILL NOT BE AVAILABLE FOR SEVERAL MONTHS; BUT IF THE EARLIER TREND CONTINUED, ISRAEL'S FOREIGN EXCHANGE RESOURCES WERE FURTHER UNDERSTATED. THE FINANCE MINISTER ESTIMATED THAT NET RESERVES WOULD RISE BY ANOTHER \$300 MILLION IN 1978. END CONFIDENTIAL.

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8. REACTION: THE KNESSET DEBATE ON THE BUDGET WILL BE HELD NEXT WEEK. IN THE MEANTIME, MUCH OF THE PRESS HAS BEEN CRITICAL OF THE BUDGET. HAARETZ (INDEPENDENT) WROTE, "ANYONE WHO EXPECTED THAT THE BUDGET--THE FIRST TO BE PREPARED FROM START TO FINISH BY MR. EHRlich--WOULD BEAR INDICATIONS OF THE CHANGE AND INNOVATION PROMISED BY THE LIKUD GOVERNMENT, IN THIS SPHERE AS IN OTHERS, WAS WRONG AND WAS DISAPPOINTED...THE TRUE TEST OF THE NEW POLICY DOES NOT LIE IN THE NOMINAL TOTAL OF THE BUDGET BUT IN THE SUBSTANTIVE DECISIONS AT ITS BASIS: REDUCING THE PUBLIC APPARATUS, ELIMINATING EMPTY ACTIONS AS WELL AS ACTIONS WHOSE BENEFIT IS TOTALLY DISPROPORTIONATE TO THEIR COST, AND INSTITUTING SAVINGS WITHIN THE GOVERNMENT. IN THIS SPHERE VIRTUALLY NOTHING HAS BEEN DONE--'VIRTUALLY' BEING EMPLOYED HERE FOR CAUTION'S SAKE ONLY--AND UNTIL SOMETHING CONCRETE IS DONE, MR. EHRlich WILL NOT BE ABLE TO CLAIM THAT HE HAS FULFILLED THE PROMISES HIS PARTY MADE TO THE PUBLIC ON THE EVE OF THE ELECTIONS." DAVAR (HISTADRUT) WAS ALSO CRITICAL, USING THE PLOY OF QUOTING EXTENSIVELY FROM EHRlich'S SPEECH IN CONFIDENTIAL

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OPPOSITION TO EX-LABOR FINANCE MINISTER RABINOWITZ' 1975 BUDGET AND APPLYING THE REMARKS TO THE NEW BUDGET. DAVAR ADDED THAT:

--THE BUDGET DOES NOT TAKE INTO ACCOUNT EITHER AN AGREEMENT WITH EGYPT OR ADDITIONAL SETTLEMENT ACTIVITY IN THE TERRITORIES,

--IT IS DOUBTFUL THAT THE BUDGET DEFICIT WILL BE AS LOW AS IL6 BILLION,

--INFLATION WILL BE HIGHER THAN PREDICTED,

--THERE IS NO CONNECTION BETWEEN THE POLICY GOALS STATED IN THE NATIONAL BUDGET AND THE ELEMENTS OF THE BUDGET ITSELF.

AL HAMISHMAR (MAPAM) ATTACKED THE PROPOSALS AS BEING ANTI-CONSUMER AND ANTI-WORKER BECAUSE OF THE SUBSIDY CUTS AND LACK OF REAL WAGE GROWTH. THE JERUSALEM POST ALLOWS THAT THE GOVERNMENT WAS SADDLED

WITH TWO MAJOR RIGID CATEGORIES, DEFENSE AND DEBT SERVICE, BUT OBJECTS THAT THE BUDGET AS PRESENTED DOES NOT GIVE AN ACCURATE PICTURE OF FY-78 EXPENDITURES. IT CALLED FOR THE TREASURY TO IMPLEMENT THE IL3 BILLION CUT IN THE BUDGET WHICH THE GOI HAS REPORTEDLY PREPARED AS A FALL BACK PLAN.

9. BANK OF ISRAEL ECONOMISTS HAVE MADE PUBLIC THEIR FEARS THAT THE BUDGET WILL RUN AN IL12 BILLION DEFICIT IN FY78, CAUSING INFLATION TO REACH 40 PERCENT INSTEAD OF THE HOPED-FOR 30 PERCENT.

S10. SEE REF A AND REF C FOR EMBASSY COMMENTS. END

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